



DEPARTMENT OF THE TREASURY  
INTERNAL REVENUE SERVICE  
**TEGE EO Examinations Mail Stop 4920 DAL**  
**1100 Commerce St.**  
**Dallas, Texas 75242**

501.03-00

TAX EXEMPT AND  
GOVERNMENT ENTITIES  
DIVISION

Release Number: **201013064**  
Release Date: 4/2/10

Date: December 29, 2009

LEGEND

ORG = ORGANIZATION NAME    XX = DATE  
ADDRESS = ADDRESS

Taxpayer Identification Number:  
Person to Contact:  
Employee Identification Number:  
Employee Telephone Number:  
(Phone)  
(Fax)

**ORG**  
**ADDRESS**

**LAST DATE TO FILE A PETITION**  
**IN TAX COURT: March 29, 20XX**

**CERTIFIED MAIL – RETURN RECEIPT**

Dear

This is a final adverse determination regarding your exempt status under section 501(c)(3) of the Internal Revenue Code (the Code). Our favorable determination letter to you dated January 19XX is hereby revoked and you are no longer exempt under section 501(a) of the Code effective January 1, 20XX.

The revocation of your exempt status was made for the following reason(s):

Organizations described in IRC 501(c)(3) and exempt under section 501(a) must be both organized and operated exclusively for exempt purposes. You have failed to produce documents to establish that you are operated exclusively for exempt purposes and that no part of your net earnings inures to the benefit of private shareholders or individuals.

Contributions to your organization are no longer deductible under IRC §170 after January 1, 20XX.

You are required to file income tax returns on Form 1120. These returns should be filed with the appropriate Service Center for the tax year ending December 31, 20XX, and for all tax years thereafter in accordance with the instructions of the return.

Processing of income tax returns and assessments of any taxes due will not be delayed should a petition for declaratory judgment be filed under section 7428 of the Internal Revenue Code.

If you decide to contest this determination under the declaratory judgment provisions of section 7428 of the Code, a petition to the United States Tax Court, the United States Claims Court, or the district court of the United States for the District of Columbia must be filed before the 91<sup>st</sup> Day

after the date this determination was mailed to you. Please contact the clerk of the appropriate court for rules regarding filing petitions for declaratory judgments by referring to the enclosed Publication 892. You may write to the United States Tax Court at the following address:

You also have the right to contact the Office of the Taxpayer Advocate. Taxpayer Advocate assistance is not a substitute for established IRS procedures, such as the formal Appeals process. The Taxpayer Advocate cannot reverse a legally correct tax determination, or extend the time fixed by law that you have to file a petition in a United States court. The Taxpayer Advocate can, however, see that a tax matter that may not have been resolved through normal channels gets prompt and proper handling. You may call toll-free and ask for Taxpayer Advocate Assistance. If you prefer, you may contact your local Taxpayer Advocate at:

See the enclosed Notice 1546, Taxpayer Advocate Service - Your Voice at the IRS, for Taxpayer Advocate telephone numbers and addresses.

You should contact your State officials if you have any questions about how this final determination may affect your State responsibilities and requirements.

If you have any questions, please contact the person whose name and telephone number are shown in the heading of this letter.

Sincerely,

Nanette M. Downing  
Acting Director, EO Examinations

Enclosures:  
Publication 892  
Publication 1546



TAX EXEMPT AND  
GOVERNMENT ENTITIES  
DIVISION

DEPARTMENT OF THE TREASURY

INTERNAL REVENUE SERVICE

TE/GE EO Examinations

Examiner's Address

Examiner's Address

**Date:** August 19, 2009

LEGEND

ORG = ORGANIZATION NAME XX = DATE

ADDRESS = ADDRESS

ORG

ADDRESS

**Form Number:**

**Tax Year Ended:**

**Taxpayer Identification Number:**

**Person to Contact:**

**Employee Identification Number:**

**Employee Telephone Number:**

(Phone)

(Fax)

**CERTIFIED MAIL – RETURN RECEIPT REQUESTED**

Dear

We have enclosed a copy of our report of examination explaining why we believe revocation of your exempt status under section 501(c)(3) of the Internal Revenue Code (Code) is necessary.

If you accept our findings, please sign and return the enclosed Form 6018, Consent to Proposed Action - Section 7428. If you have already given us a signed Form 6018, you need not repeat this process. We will issue a final revocation letter.

If you do not agree with our proposed revocation, you must submit to us a written request for Appeals Office consideration within 30 days from the date of this letter to protest our decision. Your protest should include a statement of the facts, the applicable law, and arguments in support of your position.

An Appeals officer will review your case. The Appeals office is independent of the Director, EO Examinations. The Appeals Office resolves most disputes informally and promptly. The enclosed Publication 3498, The Examination Process, and Publication 892, Exempt Organizations Appeal Procedures for Unagreed Issues, explain how to appeal an Internal Revenue Service (IRS) decision. Publication 3498 also includes information on your rights as a taxpayer and the IRS collection process.

in lieu of Letter 3618

You may also request that we refer this matter for technical advice as explained in Publication 892. If we issue a determination letter to you based on technical advice, no further administrative appeal is available to you within the IRS regarding the issue that was the subject of the technical advice.

If we do not hear from you within 30 days from the date of this letter, we will process your case based on the recommendations shown in the report of examination. If you do not protest this proposed determination within 30 days from the date of this letter, the IRS will consider it to be a failure to exhaust your available administrative remedies. Section 7428(b)(2) of the Code provides, in part: "A declaratory judgment or decree under this section shall not be issued in any proceeding unless the Tax Court, the Claims Court, or the District Court of the United States for the District of Columbia determines that the organization involved has exhausted its administrative remedies within the Internal Revenue Service." We will then issue a final revocation letter.

You have the right to contact the office of the Taxpayer Advocate. Taxpayer Advocate assistance is not a substitute for established IRS procedures, such as the formal appeals process. The Taxpayer Advocate cannot reverse a legally correct tax determination, or extend the time fixed by law that you have to file a petition in a United States court. The Taxpayer Advocate can, however, see that a tax matter that may not have been resolved through normal channels gets prompt and proper handling. You may call toll-free and ask for Taxpayer Advocate Assistance. If you prefer, you may contact your local Taxpayer Advocate at:

If you have any questions, please call the contact person at the telephone number shown in the heading of this letter. If you write, please provide a telephone number and the most convenient time to call if we need to contact you.

Thank you for your cooperation.

Sincerely,

Director, EO Examinations

Enclosures:  
Publication 892  
Publication 3498  
Report of Examination

in lieu of Letter 3618

Form <b>886A</b>	Department of the Treasury - Internal Revenue Service <b>Explanation of Items</b>	Schedule No. or Exhibit A
<b>EO: ORG</b> <b>Address</b> <b>City, State</b>		<b>Year/Period Ended</b> December 31, 20XX December 31, 20XX December 31, 20XX

**LEGEND**

ORG = Organization name      XX = Date      Address = address      City = city  
 State = state      President = president      Director = director      CO-1 = 1<sup>st</sup>  
 Company

**CASE REPORT - REVOCATION OF 501(c)(3) EXEMPT STATUS**

**EO - EIN:**

**ISSUE**

1. Whether the tax-exempt status of the EO should be revoked based on inurement issues revealed during the course of our examination.

**BACKGROUND**

The EO is recognized as a 501(c)(3) tax-exempt organization, and is a non-profit corporation under the laws of the State of State. According to its Articles of Incorporation, the primary purpose of the organization is "exclusively for charitable, religious, educational and scientific purposes including for such purposes the making of distributions to organizations that qualify as exempt organizations under 501 (c)(3) of the IRC or corresponding section of any future federal tax code." The EO is a one-person corporation operated by its President, President. The governing board of the organization consists of two members: President, President of the organization, and Director, Director of the organization. The President does not have an employment contract with the organization, and the organization does not have any internal control procedures in place or a conflict of interest policy.

**FACTS**

The EO's records demonstrated that the organization's President, President, consistently utilized the organization's income for private purposes. Our examination revealed the following inurement issues and excess benefit transactions that resulted from the organization being under the control of one-person:

- Reviewed and analyzed bank statements for the three (3) years under examination show President routine use of exempt organization income for private purpose through consistently writing checks payable to cash for personal used from CO-1 Accounts.
- President sold organization's assets for personal gain. In June 18, 20XX President quitclaim to her name a donated property to the organization located at Address, City, State and later sold it for \$.
- The Records show other properties donated to the exempt organization were sold for private benefits. A land parcel (county ID: #) located at Address, City, State donated to EO in March 7, 20XX was sold in October 9, 20XX and the proceeds deposited in the

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EO Account (#); subsequently, the money withdrawn from the account in the form of a cash transaction and checks payables to cash.

- The current governing board of the organization is composed of only two members President, President, and Director, Director. All other prior members either resigned or were deleted from the list. President controls the board and oversees daily operation.
- President is the primary signor in all organization's bank accounts. She deposits and writes checks from the accounts at her own discretion. There are no internal controls, no reconciliations of accounts, no record keeping, and no accountability.
- The records demonstrated President routine use of organization's "assets," her consistent commingling of personal and business activities using the organization's bank accounts, and inadequate records to support her activities.

## **LAW**

Section 501(c)(3) of the Code exempts from federal income tax organizations organized and operated exclusively for charitable, educational, and other exempt purposes, provided that no part of the organization's net earnings inures to the benefit of any private shareholder or individual.

Section 1.501(c)(3)-1(a)(1) of the regulations provides that in order to be exempt as an organization described in section 501(c)(3) of the Code, the organization must be one that is both organized and operated exclusively for one or more of the purposes specified in that section.

Section 1.501(c)(3)-1(c)(1) of the regulations provides that an organization will not be regarded as operated exclusively for exempt purposes if more than an insubstantial part of its activities is not in furtherance of exempt purposes.

Section 1.501(c)(3)-1(d)(ii) of the regulations provides that an organization is not organized or operated exclusively for one or more exempt purposes unless it serves a public rather than a private interest. Thus, it is necessary for an organization to establish that it is not organized or operated for the benefit of private interests such as designated individuals, the creator or his family, shareholders of the organization, or persons controlled, directly or indirectly, by such private interests.

Section 1.501(c)(3)-1(d)(2) of the regulations provides that the term "charitable" is used in section 501(c)(3) of the Code in its generally accepted legal sense, and includes the promotion of education.

The presence of a single substantial nonexempt purpose can destroy the exemption regardless of the number or importance of exempt purposes. Better Bus. Bureau v. United States, 326 U.S. 279. 283, 90 L. Ed. 67, 66 S. Ct. 112 (1945); Am. Campaign Acad. v.



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Commissioner, 92 T.C. 1053, 1065 (1989); see also Old Dominion Box Co., Inc. v. United States, 477 F.2d. 340 (4<sup>th</sup> Cir. 1973), cert. denied, 413 US 910 (1973) ("operating for the benefit of private parties who are not members of a charitable class constitutes a substantial nonexempt purpose"). When an organization operates for the benefit of private interests, such as designated individuals, the creator or his family, or persons directly or indirectly controlled by such private interests, the organization by definition does not operate exclusively for exempt purposes. Am. Campaign Acad. v. Commissioner, supra at 1065-1066, and John Marshall Law School v. United States, 228 Ct. Cl. 902 (1981).

## ISSUE # 1 – REVOCATION BASED ON INUREMENT ISSUES

### TAXPAYER'S POSITION

According to President verbal statements, the donated property in question was donated to her and not to the organization, and that it was put under the EO because she is the organization.

In regards to the checks written to cash, President claims the money was used for food, bills, and business expenses including legal fees.

### GOVERNMENT'S POSITION

We propose revocation of the organization's exempt status based on "inurement" issues revealed during the course of our examination. Regs. 1.501(c)(3)-1(c)(2) explains the prohibition against private inurement as follows; "An organization is not operated exclusively for one or more exempt purposes if its net earnings inure in whole or in part to the benefit of private individuals". Any transaction between an organization and a private individual in which the individual appears to receive a disproportionate share of the benefits of the exchange, relative to the charity served, constitutes an inurement issue. The EO's records showed that the organization's President, President, consistently utilized the organization's income for private purposes. Since, the organization is operated and run primarily by a one-person organization, it is not reasonable for the Service to accept that sufficient safeguards will be established to prevent future violations or that the organization has made good-faith efforts to seek correction from the disqualified person, as in this case, the organization *is* the disqualified person.

The EO is a one-person organization operated by its President, President with a governing board consisting of President and a Director, Director who is not involve in any part of the EO activities or decision making. A governing board that consists solely of one member does not constitute an independent body, and has an inherent conflict of interest when placed in a position to approve financial transactions involving her own. The organization does not have a conflict of interest policy, no records are kept, and no internal controls in placed evidenced the fact that operating under the control of one person suggests that an organization operates primarily for non-exempt private purposes, rather than exclusively for public purposes, which is the basis for exemption of any 501(c)(3) organization.

### Excess Benefit Transactions in Relation to Exempt Activities

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The attached word documents (Exhibits 1 thru 3) provides an itemized listing of the automatic excess benefit transactions, in which President, President, engaged with the EO in tax years 20XX, 20XX and 20XX:

The detail provided above evidences the size and scope of the excess benefit transactions at issue, and indicates that The ORG serves the interests of the President, President rather than the public interest in the years under review.

**The following graphic shows the Excess Benefit Transactions as a percentage of the organization's Total Revenues and as a percentage of President Compensation:**

EXCESS BENEFIT TRANSACTIONS AS % OF REVENUES				
DESCRIPTION	TAX YEAR			TOTAL
	20XX	20XX	20XX	
EXCESS BENEFIT TRANSACTIONS (EBTs)				
TOTAL REVENUES				
TOTAL EBTs AS % OF EO TOTAL REVENUES				

During a follow up interview on February 17, 20XX, President claimed that the donated property was given to her and not to the mission; but when asked why county records show the mission name on title, she claimed it was the same thing because she was the mission. In regards to checks written to cash, she claimed the money was used to pay for food, bills, and organization expenses. We were unable to ascertain the veracity of her assertion.

TP submitted a box of receipts and invoices that do not reflect the transactions in question under review, and submitted because they appeared to favor President; recognizing the unrelated documents would not take into account those transactions *not* submitted that may clearly favor the organization. In most questionable transactions "CASH" was the preferred method. There was no evidence submitted to believe that the money was used to pay for the organizations expenses. In fact, Most of the EO expenses were paid by checks written to suppliers and service companies. Given the facts and circumstances, it is not reasonable to expect the Service to look at "one side of the coin" in determining whether President used the cash transactions for the organization's exempt purpose. Furthermore, subsequent years (20XX & 20XX) examination of EO bank accounts demonstrated this was an on-going and routine use of organizational funds for personal purposes, her commingling of business and personal activities using the organization's bank accounts, and inadequate records to support her activities.

Our Examination revealed that the President of the EO, a one-person organization, engaged in multiple private benefit transactions throughout the periods under review. The size and scope of these transactions appears to overshadow whatever exempt accomplishments a reasonable person might expect to gain from any *one-person* organization. Due to a complete lack of financial oversight, the cost of furthering this organization's exempt purpose appears to outweigh the benefits received.



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It is not reasonable for the Service to accept that President will establish safeguards to prevent future violations. It is also not reasonable for the Service to accept that the EO has made good faith efforts to seek correction from the disqualified person who benefited from the transactions when the organization and the disqualified person are still operating in the same manner since 20XX, the first year under examination.

Given the size and scope of the inurement issues revealed by our examination, the EO is not operated exclusively for exempt purposes, and does not qualify for exemption under IRC § 501(c)(3). Once President has employed his best efforts to populate the Board with additional members representative of the community she serves; has implemented good internal controls; record keeping; has found competent financial help; has adopted a conflict of interest policy; and organized financially and operationally; then, the new organization could then reapply for exemption. The new application would also require President to appoint a Treasurer and a check writing policy where she will no be the primary signor.

Based on the facts and circumstances, the EO is not operated exclusively for exempt purposes and, therefore, does not qualify for exemption under IRC § 501(c)(3).

#### **CONCLUSION:**

It is the Service's position that the organization and Its President, President engaged in multiple and repeated private benefit and inurement transactions with the organization's President, a Disqualified Person, under IRC § 4958, and as a result, is no longer eligible for exemption from federal income tax under IRC § 501(c)(3).

Accordingly, the organization's exempt status is revoked effective **January 1, 20XX**.

Form 1120 returns should be filed for tax periods ending on or after December 31, 20XX.